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Todd F. Silbergeld
Director
Federal Regulatory

SBC Telecommunications, Inc.
1401 I Street, N.W.
Suite 1100
Washington, D.C. 20005
Phone 202 326-8888
Fax 202 408-4806
Email: tsilber@corp.sbc.com

EX PARTE OR LATE FILED

May 7, 1999

NOTICE OF EX PARTE PRESENTATION

Magalie Roman Salas, Esq.
Secretary
Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
Washington, D.C. 20554

CC Docket No. 98-141

Re: *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*

Dear Ms. Salas:

Please be advised that yesterday Michael K. Kellogg, Peter Huber and the undersigned, representing SBC Communications Inc., met with Carol E. Mattey, Michael H. Pryor, Jake E. Jennings and Christopher Libertelli of the Common Carrier Bureau regarding the above-referenced docketed matter. At the staff's request, we discussed SBC's preliminary analysis and thoughts in connection the Commission's recent notice of proposed rule making. Representatives referred to the attached memorandum during our discussion.

In accordance with the Commission's rules concerning ex parte presentations, one copy of this notification and associated materials are provided herewith. Please contact me directly should you have any questions regarding the foregoing.

Respectfully submitted,

Todd F. Silbergeld

Attachment

cc: Carol E. Mattey, Esq.
Michael H. Pryor, Esq.
Mr. Jake E. Jennings
Christopher Libertelli, Esq.

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The Limits on Unbundling Imposed by Section 251(d)(2)

The Supreme Court has ruled that section 251(d)(2) requires a rational determination as to "*which* network elements must be made available, taking into account the objectives of the Act and giving some substance to the 'necessary' and 'impair' requirements." *AT&T Corp. v. Iowa Utils. Bd.*, No. 97-826 (and consolidated cases), slip op. at 24 (U.S. Jan. 25, 1999). In other words, the 1996 Act cannot be understood to require ILECs to make available all those elements in their networks to which it is feasible to provide access. Instead, an ILEC may be *required* to make a particular element available *only* if that element *should* be made available in light of the criteria set forth in section 251(d)(2) and the objectives of the Act as a whole.[1]

This white paper summarizes SBC's preliminary views on how the FCC should give substance to the "necessary" and "impair" requirements of section 251(d)(2). It is divided into two parts. The first contains SBC's initial thoughts on the scope of the section 251(d)(2) inquiry, consistent with the guidance provided by the Supreme Court on this issue. The second contains SBC's views on the steps that the FCC should take immediately to gather factual information that will be essential to its section 251(d)(2) inquiry.

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[1]Whatever the Act requires where no agreement is reached, it remains our fundamental belief that the Act contemplates business-to-business negotiations to arrive at an appropriate interconnection agreement that satisfies the needs of our CLEC customers. We are fully committed to that process. Indeed, SBC has already negotiated hundreds of agreements under the Act, only a small percentage of which have been subject to arbitration.

A. The Scope of Section 251(d)(2).

SBC will present its final views on the precise scope of the section 251(d)(2) inquiry in its remand comments. We look forward to working with the Commission throughout that process to ensure that section 251(d)(2) is applied in a way that maximizes true competition to the benefit of American consumers. Here, we would like to make a number of preliminary points for the Commission's consideration as it prepares its Notice of Proposed Rulemaking on remand.

First, under section 251(d)(2)(A), a "proprietary" element is to be made available only if access to that element is "necessary." The term "proprietary" is not defined in the statute, but should be read to include any element as to which the ILEC is properly viewed as having a proprietary interest; at a minimum, for example, an element is proprietary if it is protected by patent, copyright, trade secret, or other similar laws. *See* U.S. Department of Justice, *Antitrust Guidelines for the Licensing of Intellectual Property* § 1 (1996). Moreover, as the Commission indicated in its *Local Competition Order* (at ¶ 282),[2] a network element is proprietary if it contains any "proprietary protocols or elements containing proprietary information."

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[2]First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 15641-42 (1996) ("*Local Competition Order*"), *modified on recon.*, 11 FCC Rcd 13042 (1996), *vacated in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, No. 97-826 (U.S. Jan. 25, 1999).

By "necessary," in our view, section 251(d)(2)(A) indicates that a "proprietary" element need not be provided unless it is both essential to competitive entry and unattainable from any other source. This limitation is in keeping with the high degree of protection traditionally afforded to intellectual property as against competitors seeking access to that property. *See, e.g., Data General Corp. v. Grumman Systems Support Corp.*, 36 F.3d 1147, 1187 & n.64 (1st Cir. 1994) (an author's desire to exclude others from use of its copyrighted work is presumptively valid, and will be overridden only in "rare cases"); *Miller Insituform, Inc. v. Insituform of North America*, 830 F.2d 606, 609 (6th Cir. 1987) ("A patent holder who lawfully acquires a patent" cannot ordinarily be required "to license the patent to others."); *United States v. Westinghouse Elec. Corp.*, 648 F.2d 642, 647 (9th Cir. 1981) (same).

Second, even if not proprietary, a network element is to be provided only if it satisfies the "impair" standard of section 251(d)(2)(B). This is the threshold test that every element in Rule 319 must meet. [3]

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[3]The Commission should reject AT&T's casual but insistent suggestion that the "necessary and impair" standard only applies to proprietary network elements. AT&T White Paper at 10, 15 & n.12. As the Commission recognized in its *Local Competition Order*, it is clear that the words "such network elements" in subsection (B) refer, without qualification, to the determination of "what network elements should be made available." In other words, the "impair" standard applies to all such network elements. *See* 11 FCC Rcd at 15641-43 [¶¶ 283-285]. By contrast, the "necessary" standard only applies to "such network elements as are proprietary." That is plainly how the Supreme Court read the provision when it summarized "the 1996 Act's requirement that [the Commission] consider whether access to proprietary elements was 'necessary' and whether lack of access to nonproprietary elements would 'impair' an entrant's ability to provide local service. *See* § 251(d)(2)." *Iowa Utils. Bd.*, slip op. at 7.

In our view, the basic thrust of the "impair" prong of the section 251(d)(2) inquiry is whether failure to provide access to a particular network element would preclude *meaningful opportunities for competitive entry by an efficient competitor.*[4] This test is taken directly from the *Local Competition Order* (at ¶ 315), in which the Commission, discussing the non-discrimination obligation, ruled that network elements must be provided "on terms and conditions that would provide an efficient competitor with a meaningful opportunity to compete." The Commission found that this standard is directly tied to the purposes underlying section 251, and it answers the question of what elements must be provided as well as how those elements should be provided. In other words, Congress wanted CLECs to have access to those UNEs that they need to compete, on terms that would allow them to compete.

Stated in this way, it is clear that the "impair" inquiry is necessarily focused on the alternative opportunities available to CLECs. If an efficient new entrant could compete without obtaining the network element in question from the ILEC, then that element should not be included in the Commission's revised Rule 319. And the best evidence of what an efficient competitor *could* do is what actual competitors are doing. If a competitor is currently providing

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[4]In a recent letter, the Association for Local Telecommunications Services ("ALTS") has proposed a slightly different formulation: whether failure to provide access to the element in question would "preclude opportunities for meaningful competitive entry." Letter from John Windhausen to Lawrence E. Strickling at 2 (undated). There may be no practical difference between the two standards, but it is not clear what "meaningful competitive entry" means, and it might be read to imply some sort of "market share" test that is wholly inappropriate. As long as meaningful opportunities for entry exist without access to a particular ILEC element, the degree of actual entry is irrelevant.

service without access to a particular ILEC element, that is conclusive evidence that an efficient competitor *can* compete without access to the element in question.[5]

Thus, the Commission's inquiry is necessarily fact-based and will require, as discussed in Part B of this paper, a detailed examination of alternative sources for network elements. For example, ALTS notes that "hundreds of switches have been deployed" by new entrants. ALTS Letter at 2. If the Commission's factual inquiry bears out this claim then, plainly, switching should not be included in Rule 319. It is no answer for a CLEC to argue that it might be more "convenient" for a CLEC to obtain switching (particularly in bundled form) from the ILEC.[6]

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[5]As Justice Breyer explained in his separate concurrence on this point, while it might make sense in some circumstances to require a railroad to share "bridges, tunnels, or track" -- items that cannot practically be duplicated by a competitor -- it does not make sense "to require a railroad to share its locomotives, fuel, or workforce" -- all items that a competitor can readily obtain from other sources. *Iowa Utils. Bd.*, slip op. at 18-19 (Breyer, J., concurring in part and dissenting in part).

[6]In a recent white paper of its own, AT&T has argued that the Commission can reinstate the current list of unbundled network elements (even with expanded definitions of each element) with little or no additional analysis. AT&T proposes as a relevant standard under section 251(d)(2) whether "CLECs' ability to provide [a] proposed service would be adversely affected if they were required to use a proposed substitute." AT&T White Paper at 13. By "adversely affected," moreover, AT&T means any "non-trivial" difference in the cost, quality, scope, convenience (for the CLEC), or timing of introduction of the service in question. *Id.* at 14. But this is not a limiting standard. AT&T is simply thumbing its nose at the Supreme Court.

Not surprisingly, AT&T blithely assures the Commission -- *without any factual analysis whatsoever* -- that every network element previously identified by the Commission satisfies this so-called "standard." The *reductio ad absurdem* of AT&T's position is found in its discussion of the network interface device ("NID"), which is an inexpensive, off-the-shelf piece of equipment that any CLEC could acquire in the open market. AT&T solemnly assures the Commission that "there is no economically practical substitute available" to the ILEC NID, which therefore satisfies section 251(d)(2). *Id.* at 35-36.

Third, we agree with the apparent implication of ALTS's letter that the "impair" standard does not turn on the identity of the requesting carrier. The proper purpose of any unbundling requirement is to promote competition, not to aid individual competitors. *See* 3 A P. Areeda & H. Hovencamp, *Antitrust Law* ¶¶ 771-777 (1996). As the Commission itself recognized, section 251 is properly focused on what is needed to "provide an *efficient competitor* with a meaningful opportunity to compete." *Local Competition Order* at ¶ 315 (emphasis added). If efficient competitors can, and do, provide service without access to a particular network element, it is irrelevant whether a less efficient competitor might claim that -- due to size, cash flow, network configuration or other considerations -- it needs access to that element in order to compete.

We also agree that the current business plans of various CLECs are not relevant to the "impair" inquiry. Thus, the fact that all the CLECs in a particular area might be using their switches only to target business customers does not mean that switching for residential customers should be provided as a network element. Those same switches that currently serve business customers could readily be used to serve residential customers as well.

At the same time, we disagree with ALTS's and AT&T's suggestion that any "market-specific analyses" should be excluded. ALTS Letter at 2; AT&T White Paper at 3 (elements listed in 319 must "be made available on the same basis in all geographic areas, to all new entrants, and for all types of customers"). Obviously, the ability of CLECs to compete without access to a particular ILEC network element may vary depending upon the geographic market (urban, suburban, rural) in question. In its *Local Competition Order*, the Commission

established a minimum of three cost-related rate zones based on geographic density. See 47 C.F.R. § 51.507(f). A similar sensitivity to geographic variations is appropriate here.

For example, ALTS asserts that, while hundreds of switches have been deployed, few of its members "have provisioned their own local loops." ALTS Letter at 2. But, in fact, hundreds of CLECs have provisioned loops in downtown business areas. In those markets, non-use of ILEC loops has not precluded competitive entry. By contrast, CLECs may have less opportunity to serve rural residential areas without access to ILEC loops, although even here, alternatives such as cable loops and fixed wireless are being developed. The existence of all such alternatives must be considered in order fully to abide by the Supreme Court's decision.

Fourth, the CLECs cannot "bootstrap" elements onto the Rule 319 list by relying on the Commission's TELRIC pricing principles. In other words, the CLECs cannot argue that, because the TELRIC price for an element will be so low, no CLEC could do better by self-provisioning the element in question or obtaining it from another source. Such sleight-of-hand would clearly be antithetical to the Supreme Court's mandate and to the purposes of the Act in terms of developing genuine competitive alternatives to the ILEC. The proper focus is not on the rate at which a regulator might set the price for a network element from the ILEC. The proper focus is on whether an efficient new entrant has a meaningful opportunity to compete by obtaining the element in question from a source other than the ILEC.[7]

[7]Moreover, and in any event, any such attempt at "bootstrapping" would be inconsistent with the whole TELRIC inquiry, which was designed to determine the price at which an ILEC's

Fifth, in determining what elements should be included in Rule 319, no consideration can be given to Rule 315(b)'s requirement that the ILECs not separate network elements already combined in their networks. If an element can be obtained from a source other than the ILEC, the mere fact that it would be less expensive and more convenient to get that element from the ILEC already combined in the network with another element is not a sufficient basis to put it on the list of network elements that must be made available in the first place.

AT&T's discussion of the NID provides a case in point. Despite the fact that NIDs are inexpensive, off-the-shelf pieces of equipment that could be obtained from numerous non-ILEC sources, AT&T argues that NIDs must be included in Rule 319 because it would "needlessly increase the CLEC's costs" if the CLEC could not get the NID pre-combined with the loop. AT&T White Paper at 28. But the Commission cannot even reach the issue of combining network elements until it determines which elements should be made available under the standards of section 251(d)(2). If an element, judged in isolation, does not meet the section 251(d)(2) test -- and NIDs plainly do not -- then the Commission cannot order that element to be provided, regardless of whether or not it is already combined in the ILEC's network. That is why, as the Supreme Court indicated, the whole question of the so-called "UNE platform" is

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network could be replicated using its wire center locations and the most efficient technology available. In adopting TELRIC, the Commission rejected a pricing methodology that would have allowed ILECs to recover the cost of network elements based upon their existing network design and technology in operation today. According to the Commission, this would result in prices "that reflect inefficient or obsolete network design and technology." *Local Competition Order* (at ¶684). By definition, therefore, any network element that is priced at TELRIC should be available at that same price from another source and be the most efficient technology available.

likely to become "academic" once the Commission properly applies section 251(d)(2). *Iowa Utils. Bd.*, slip op. at 25; *id.* at 26.[8]

Sixth, the fact that the Bell Operating Companies is required to provide some elements in some circumstances in order to obtain section 271 relief does not mean that those elements should automatically be included in Rule 319. Congress's decision to include certain elements in the section 271 checklist reflects the fact that a BOC could have applied for 271 relief before the FCC even issued its initial UNE rules. That does not mean that Congress predetermined whether those elements would be required under section 251(d)(2). Congress mandated that the Commission go through the section 251(d)(2) inquiry before ordering that *any* element be made available. If it had wanted to require a minimum list of network elements, it could have and would have so provided. Section 271(c)(2)(B) does not relieve the Commission of its independent duty to apply the standards of section 251(d)(2).

Seventh, the Commission's unbundling determination must be undertaken with an eye to the "significant administrative and social costs" of too much unbundling identified by Justice Breyer in his concurrence on this point. Justice Breyer noted that there were three main

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[8]Recognizing this point, AT&T suggests that the NID "could be treated as part of the loop element." AT&T White Paper at 36 n.29. But such an approach is antithetical to the Commission's history of unbundling any elements that can be competitively provided. The whole point of unbundling, for example, CPE and inside wire from basic telephone service was because those elements could, and therefore should, be provided competitively. The NID can and should be provided competitively and it would be a complete and unjustified about-face for the Commission now to bundle it with the loop simply because the NID doesn't qualify under section 251(d)(2) as a network element that must be provided by ILECs to CLECs.

objections to too much unbundling. *First*, sharing entails significant administrative costs because "someone must oversee the terms and conditions of that sharing." *Id.* at 19 (Breyer, J., concurring in part and dissenting in part). *Second*, "a sharing requirement may diminish the original owner's incentive to keep up or to improve the property by depriving the owner of the fruits of value-creating investment, research, or labor." *Id.* *Third*, "[i]ncreased sharing by itself does not automatically mean increased competition. It is in the *un*shared, not in the shared, portions of the enterprise that meaningful competition would likely emerge." *Id.* at 19. Any valid unbundling rules, Justice Breyer explained, must "sufficiently reflect or explore this other side of the unbundling coin." *Id.* at 20.

Accordingly, a proper result on remand will require a balancing of the competitive benefits of unbundling and the potential costs of too much unbundling, in light of the language of section 251(d)(2) and the objectives of the Act as a whole. This balance may be different in different contexts. For example, the potential social costs of unbundling are particularly severe when applied to new technologies, such as broadband facilities. Michael Armstrong, Chairman of AT&T, has recently acknowledged that "[n]o company will invest billions of dollars to become a facilities-based . . . services provider if competitors who have not invested a penny of capital nor taken an ounce of risk can come along and *get a free ride* on the investments and risks of others." Remarks of C. Michael Armstrong, Chairman and Chief Executive Officer, AT&T, delivered to Washington Metropolitan Cable Club, Washington, D.C. (Nov. 2, 1998) (emphasis added). Whatever the impact of unbundling rules on the existing telephone network, certainly no ILEC will undertake the significant risk of investing in new technologies without the prospect of

a commensurably significant reward. The combination of an unbundling requirement and TELRIC pricing would completely eviscerate an ILEC's incentive to deploy such technologies, by leaving the ILEC with all the risk and none of the reward. Yet, by definition, such new technologies are not uniquely available to the ILEC and, given the non-discrimination and network disclosure safeguards already in place, the ILEC has no head start in their deployment. Under any proper 251(d)(2) standard, therefore, ILECs should not be required to unbundle such new technologies. SBC will accordingly file shortly with the Commission a paper setting forth its views on how the Commission's recent *Advanced Services Order*[9] should be adjusted in light of the Supreme Court's decision.

B. The Remand Inquiry.

Whatever the precise scope of the section 251(d)(2) inquiry, the Supreme Court has made clear that, at a minimum, before the Commission can construct a new list of network elements that must be provided on an unbundled basis, it must carefully consider with respect to each network element (1) whether the element is available from sources outside the ILECs' networks, and (2) whether lack of access to the element would increase competitors' costs or decrease the quality of their service sufficiently to "impair" their ability to provide the service in question.

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[9]Memorandum Opinion and Order, and Notice of Proposed Rulemaking, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket 98-147, *et al.*, FCC 98-188 (rel. Aug. 7, 1998).

Because these questions are essentially factual ones, the Commission can resolve this matter *only* after evaluating accurate information regarding how the CLECs are providing competitive local services today and what sources of equipment are available as alternatives to the ILECs' network elements. The Commission's inquiry, in other words, must center on what the CLECs have actually obtained, *can* obtain, or potentially *could* obtain, elsewhere. The ILECs enter the analysis only as a point of comparison. The Commission must determine whether requiring CLECs to rely on these outside sources, rather than the ILECs, would preclude competitive entry.

The following information, at a minimum, is therefore essential to the Commission's remand inquiry:[10]

- The extent of competing carriers' existing facilities.

- How readily competing carriers could build-out or add to those facilities through additional purchases of equipment or services from sources other than the ILECs .

- The extent to which sources other than the ILECs actually do, or potentially could, supply services or equipment that are viable substitutes for the ILECs' network elements.

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[10]SBC also agrees with the more detailed list included in GTE's recent submission on this issue. *See* Letter from Alan F. Ciamporcero, Vice President, Regulatory Affairs to Lawrence E. Strickling, Chief, Common Carrier Bureau at 2-3 (Feb. 18, 1999).

- How much it would cost -- on a forward-looking, long-run incremental basis -- for a competitive carrier to obtain a particular element from a source other than an ILEC.

These inquiries must be made on a market-specific basis. As the Commission has emphasized in many other proceedings, competitive conditions vary widely across product, service, and geographic markets. *See, e.g.,* Memorandum Opinion and Order, *Applications of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries*, 12 FCC Rcd 19985, 20014-19 [¶¶ 49-57] (1997). In addition, given the extremely dynamic character of local exchange competition, the Commission must devise some means for updating these market data on an ongoing basis, so that it may revise accordingly the list of network elements that should be made available.

Quite plainly, the information described above must come chiefly from the CLECs, their non-ILEC service providers, and their equipment vendors. As the Commission recognized only two months ago, it currently has almost none of this crucial information. In a December 1998 report describing the state of local competition, the Common Carrier Bureau stated that the Commission "does not yet possess the detailed information necessary to evaluate the current state of local telephone competition on a market-by-market basis." Industry Analysis Division, Common Carrier Bureau, FCC, *Report on Local Competition* at 3 (issued Dec. 1998). The Bureau attributed the Commission's inability accurately to assess the state of local competition to the fact that "new entrants have not reported this type of information to the Commission or to any other source on a consistent basis" and that the Commission "gathers almost no systematic

information from new entrants (also known as competitive local exchange carriers, or CLECs)." *Id.*

In short, the Commission -- by its own admission -- currently lacks the information that it needs to answer the questions the Supreme Court identified as critical to any section 251(d)(2) analysis. Without these essential facts, the Commission has no basis for proposing a replacement for Rule 319, nor do interested parties have a foundation on which to base their comments.

In these circumstances, the Commission should take immediate steps to gather the information that it currently lacks regarding competitive alternatives to the ILECs' network elements. It should direct the CLECs, their non-ILEC service providers, and their equipment providers to submit, on an expedited basis, element-specific and market-specific information relating to the availability of network elements outside the ILECs' networks and the extent to which lack of access to those network elements will increase the CLECs' costs or decrease the quality of their services. The Commission has ample authority to undertake such an inquiry.[11] It

[11] *See, e.g.*, 47 U.S.C. § 219 (authorizing the Commission to require all carriers subject to the Act to provide "specific answers to all questions upon which the Commission may need information"); *id.* § 403 (giving the Commission express power to launch an inquiry "as to any matter or thing . . . concerning which any question may arise under any of the provisions of this chapter"); *id.* § 409(e) (authorizing the Commission "to require by subpoena the attendance and testimony of witnesses and the production of all books, papers, . . . and documents relating to any matter under investigation"); 47 C.F.R. § 1.1 ("The Commission may on its own motion or petition of any interested party hold such proceedings as it may deem necessary from time to time in connection with the investigation of any matter which it has power to investigate under the law, or for the purpose of obtaining information necessary or helpful in the determination of its policies, the carrying out of its duties or the formulation or amendment of its rules and regulations. For such purposes it may subpoena witnesses and require the production of

should exercise that authority, if necessary, by exercising its subpoena power. The Commission cannot afford to be passive: merely inviting interested parties to submit relevant information if they choose to do so will not suffice. Unless the Commission takes affirmative steps to compile the necessary data, it will lack a sufficient factual record on which to base the findings called for by the statute and the Supreme Court.

The Commission should begin the fact-gathering immediately so that it will have access to the essential information *before* it attempts to formulate and propose any new rule to replace Rule 319. The information should be made public to permit interested parties meaningfully to assist the agency in responding properly to the Supreme Court's mandate. There is no need for the Commission to await the Eighth Circuit's issuance of a revised mandate in light of the Supreme Court's decision. The Commission has all the authority it needs right now to gather the required information. Any delay in beginning that effort will necessarily affect the agency's capacity to adopt a new final rule on an expedited basis.

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evidence.").